

**STATE INVESTMENT COMMISSION
MINUTES
FEBRUARY 5, 2003**

The State Investment Commission ("the Commission") meeting was called to order by Gordon Duke, Secretary, Finance and Administration Cabinet at 2:00 p.m. on February 5, 2003, in Room 264 of the Capitol Annex. Other members present were Ellen Bale, South Central Bancshares of Kentucky, Inc; Brooke Parker, proxy for Jonathan Miller, Treasurer; and James O. King, Peoples State Bank.

Secretary Duke confirmed a quorum was present and that the press had been notified of the meeting. The first item on the agenda was approval of the November 14, 2002 minutes. A motion was made by Mr. King and seconded by Ms. Parker. Motion **CARRIED**.

Mr. Dwight Price, portfolio manager, Office of Financial Management ("OFM"), introduced Mr. George R. Burgess, Jr. to the Commission. Mr. Price indicated that Mr. Burgess accepted the position of executive director of OFM, replacing Don Mullis who retired in November 2002. Mr. Burgess comes to OFM from Farmers Bank and Capital Trust. Secretary Duke indicated that Mr. Burgess is originally from Morehead, Kentucky and brings to the Commission an extensive knowledge of state government operations having worked in the Governor's Office for Policy and Management and the Commerce Cabinet. Secretary Duke informed the Commission members that prior to hiring Mr. Burgess, he met with the Ethics Commission and was assured that since Mr. Burgess was not involved with any aspect of the banking contract while at Farmers, no conflict of interest would exist if he were hired.

Secretary Duke introduced Attachment A on the agenda, a Resolution appointing Mr. Burgess as Secretary to the Commission. A motion was made by Mr. King and seconded by Ms. Bale to approve the Resolution naming George R. Burgess, Jr. as secretary to the State Investment Commission. Motion **CARRIED**.

Secretary Duke asked Mr. Price to give the Commission members an overview of the investment market. He indicated that interest rates have been very range bound and he felt rates would continue to be range bound until the economy begins to recover. Mr. Price indicated that there has been little or no increase in loan demand.

Mr. King stated that the University of Kentucky held an economic outlook conference and the outlook remains negative with no immediate change in the economy.

Secretary Duke indicated that the Monthly General Fund Receipt Report shows collections for the General Fund by category. Investment Income is displayed in the report net of interest expenses that relate to borrowing costs incurred when the General Fund borrows from other funds. Secretary Duke indicated that we are approaching a situation, because of negative cashflow, where investment income may reflect a negative balance. Secretary Duke stated that he is fearful if the Receipts Report reflects a negative balance, it could be perceived that the Commonwealth has invested in securities that have resulted in a loss to the Commonwealth. Secretary Duke indicated that he has asked Ed Ross to work with Treasury and the Revenue Cabinet to report the investment balance to reflect both income and expenses.

Mr. King indicated he has read that tax receipts are down in Kentucky, particularly corporate tax receipts. He asked if the decrease in corporate tax receipts was due to the use of LLCs and Sub S Corporations versus the loss of actual C Corp business in the state. Mr. Tom Howard, Deputy Director, OFM stated

that the Governor's Office of Economic Analysis compiles statistics of this nature. He indicated that he would provide members with their website or send the most recent reports on this issue.

Mr. Price stated that the next item on the agenda is revisions to 200 KAR 12:011. The changes will make the language in the regulations more consistent, definitions will be clearer, and additional definitions will be added. Mr. Price indicated that no new securities were being added. Secretary Duke indicated that on page 2, item (6), delete "and Economic Analysis" and the same correction should be made in item (8). Mr. Price indicated that the Office of Legal and Legislative Affairs has reviewed the proposed changes to the regulation. Mr. Price indicated a public hearing would be scheduled to address the changes.

A motion was made by Jim King and seconded by Ellen Bale to adopt the changes to 200 KAR 12:00. Motion **CARRIED**.

Mr. Price informed the Commission members that a charge of 5 basis points is assessed the specific pools to defray the cost of operating expenses for each pool. Mr. Price indicated that consideration is being given to raising the annualized charge 1-2 basis points. Mr. Price informed the members that the conversion from the Bank of New York to State Street Bank for custodial services resulted not only in better service but increased expenses for the services. In the past these expenses have been paid for out of the General Fund. Staff feels that it is appropriate for owners of the securities to pay for the custody of them. Mr. Price indicated no action was necessary at this time, but this may be an item for approval once a budget is adopted.

Mr. Price continued with a discussion of the results of the Securities Lending Request for Proposals. Mr. Price indicated there were eight responses to the proposal. The ranking of each respondent is included in Attachment C. The primary factors involved in the ranking are the amount of money the firm can make for the Commonwealth and the firm's ability to interface with State Street Bank. As a result of the ranking, Credit Suisse First Boston was awarded the contract to provided securities lending services for the next two years.

With no further business before the Commission, the meeting was adjourned at 2:45 p.m.

Respectfully submitted,

Secretary
State Investment Commission